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For Interest Rates, The Impact Of Recession . . .

Despite continuing evidence of a deep recession, a further moderation of rates of inflation and some abatement of short-term business credit demands, interest rates have begun to move higher. With the financial markets now focusing on the possibility of a renewed acceleration of money supply growth, as well as the extremely dismal Federal budget outlook, autumn's money and bond market rallies sputtered as winter appeared. During the four weeks ending December 23, for example, some short-term interest rates increased by as much as 125 basis points, while top-quality corporate bond yields rose up to 55 basis points. But with the economy remaining weak and the growth of short-term business credit demands expected to slow further due to both seasonal and cyclical factors, additional interest rate declines in early 1982 are likely.

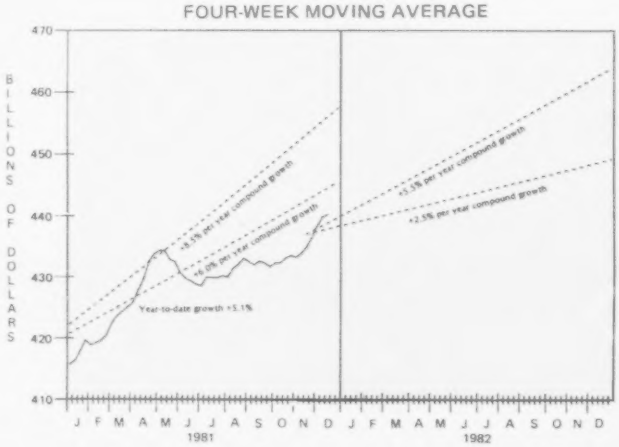
One of the major prerequisites for such declines is, however, a flattened pace of private sector economic activity. With the Federal Reserve no longer pegging interest rates rigorously and with Federal government borrowings absorbing an ever-larger proportion of net national savings (Economic Report—November, 1981), any recovery in private credit demands will simply collide with Federal requirements—and push interest rates higher. At the moment, this does not appear likely, for there is little doubt that the pace of economic activity contracted sharply in the fourth quarter, and will remain weak in the current quarter. Among the more recent indicators of the continuing slump into which the economy has fallen was the fourth consecutive monthly decline in the index of leading economic indicators in November, the very weak pace of new automobile sales, the free-fall in the number of housing starts and a pervasive weakness in such areas as industrial production, factory orders and export prospects.

Undoubtedly, this slide in economic activity has been the major factor buoying the financial markets, reducing private credit demands as well as prompting lower rates of inflation. And since the shape of the downturn that has emerged is quite traditional in scope—with across-the-board effects on a variety of industries and regions, together with increases in the unemployment rate in most sectors of the economy—a longer decline than occurred in 1980 appears likely. What is more, with little evidence of any near-term strength in the economy (except for the defense and defense-related sectors), further sharp cutbacks in employment, inventories and capital outlays are likely. This, in turn, should keep private sector credit demands restrained, at least through the first quarter of 1982.

. . . Gives Way To Money Supply Fears . . .

In the interim, however, fears of a renewed surge in money supply growth have affected negatively the financial markets. The growth of the monetary aggregates M1-B and M2 increased sharply in November, with both expanding at seasonally adjusted double-digit annual rates. As a result, while the year-to-date growth of M1-B still lies below its lower growth target boundary for 1981, M2 is now above its upper target boundary. This suggests that the Federal Reserve will adopt a somewhat more

MONEY SUPPLY, M1-B
FOUR-WEEK MOVING AVERAGE



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cautious monetary policy posture in coming weeks.

Interestingly, the acceleration in money growth in November and early December comes at an inopportune time. Since the Federal Reserve's money supply growth targets are calculated from the fourth quarter average of the series in one year to the fourth quarter average of the following year, a bulge in the money supply late in December could leave the level of the targeted aggregate at year-end exceeding its fourth quarter average by a wide margin. And, as shown in the chart on page 1, if M1-B growth in December equals that of November and the Federal Reserve does indeed scale back its 1982 growth targets for M1 to 2½—5½ per cent, the Federal Reserve will find itself in the peculiar position of undershooting its 1981 lower growth target (the October-December average) while at the same time already exceeding its 1982 upper growth target boundary. What this implies is that in the absence of any change in either the targets or the starting point, recent money supply developments could signal further restraint at a time when economic conditions would suggest some ease. Of course, the targets for 2182 are preliminary and subject to change; they, together with the definition of M1 as well as the starting point for allowable

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 12/23/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov't and Agencies Owned Outright & RPs	138.831	+ 1.247	+10.745
Loans to Depository Inst.	.621	+ .223	– 1.028
Float	4.018	+ .490	– 2.020
Total Reserve Bank Credit	153.396	+ 2.052	+ 9.223
Treasury Deposits with Federal Reserve Banks	3.215	+ .443	+ .928
Currency Outside Banks	128.932	+ 1.781	+ 6.017
Member Bank Reserves:			
Required	41.721	– .410	+ 1.692
Excess (Deficiency)	.377	+ .315	– .432
Total Reserves Held	42.098	– .095	+ 1.260
Net Borrowed Reserves	.174	– .097	– .547
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	96.347	+ 1.751	+ 3.384

Monetary Aggregates †		% Change Since Three Months Ago*	% Change Since Year Ago
M1-B (12/16/81)	440.4	+ 7.1‡	+ 5.3‡
M2 (November '81)	1,824.6	+ 10.7	+ 9.4
M3 (November '81)	2,168.3	+ 9.6	+ 11.1
L (September '81)	2,574.4	+ 11.4	+ 11.5

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 12/30/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	11.25%	12.10%	12.05%
* Federal Agencies	12.30	12.85	13.25
* Project Notes—Taxfree (46% Taxable Equivalent)	12.50	12.96	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	13.00	13.75	14.75

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	12.50%	Jan.	12.45%
15- 29 days	12.50	Feb.	12.45
30- 59 days	12.63	Mar.	12.60
60- 89 days	12.63	Apr.	12.80
90-179 days	12.25	May	13.00
180-239 days	11.25	Jun.	13.00
240-270 days	11.25		

‡Industrial Paper—Prime			
30- 89 days	12.50%	†Federal Funds Effective Rate	12.95%
90-120 days	12.63		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'81	$ 2,965	$ 2,886	$ 2,637
Gross National Product (1972 Dollars)*	3rd Q'81	$ 1,516	$ 1,510	$ 1,472
Percent Change, Annual Rate	3rd Q'81	1.4	– 1.6	2.4
Change in Consumer Prices (all urban consumers)*	Nov '81	6.0%	4.8%	13.2%
Change in Producer Prices*	Nov '81	6.0%	7.2%	8.4%
Civilian Employment (Thousands of Persons)†	Nov '81	98,025	98,217	97,339
Unemployment as % of Civilian Labor Force†	Nov '81	8.4%	8.0%	7.5%
Personal Income*	Nov '81	$ 2,489	$ 2,475	$ 2,258
Leading Indicators Composite Index (1967=100)†	Nov '81n	127.8	128.2	136.5
Industrial Production Index (1967=100) †	Nov '81	146.5	149.6	149.2
Net Change in Consumer Installment Credit†	Oct '81	$ 1.01	$ 2.82	$ 0.70
U.S. Merchandise Trade Balance †	Oct '81	–$ 4.19	–$ 1.57	–$ 1.13
Plant and Equipment Expenditures*	1st Q'82	$345.46(a)	$332.69(a)	$312.24
Private Housing Starts (Thousands of Units)*	Nov '81	871	864	1,550
New Construction Expenditures*	Oct '81	$ 230.8	$ 234.7	$ 228.9
Total Business Inventories†	Oct '81	$ 513.0	$ 508.1	$ 473.6
Total Business Sales†	Oct '81	$ 345.5	$ 353.7	$ 335.9

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

growth in 1982 could all be changed in the very near future.

. . . And a Huge Federal Deficit

Also dominating financial market developments has been the Federal budget, or, more appropriately, the Federal budget deficit. It now appears that the fiscal 1982 "recession" deficit could exceed $100 billion in the absence of any additional spending cuts and/or tax increases and, to this total, must be added the outlays of the off-budget agencies, principally the Federal Financing Bank. These outlays could reach $25 billion in fiscal 1982—yielding an enlarged Federal deficit of more than $125 billion. This compares with an enlarged deficit of less than $80 billion in fiscal 1981 (which itself was a new record) implying that a revival of private sector credit demands in 1982 will collide head-on with both the ever-expanding public sector borrowing requirement and monetary policy restraint.

Against this backdrop, those much heralded interest rate declines in early 1982 will probably have to be prompted more by weakening demand factors rather than supply-side actions by the Fed. One of the most important of these is the growth of short-term business credit demands. While these demands have moderated somewhat in recent weeks in line with

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (12/16/81)	134,966	+ 1,624	+23,765
New York City (12/16/81)	34,577	+ 328	+ 7,120
Commercial Paper (12/16/81)	165,952	+ 270	+43,895

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/16/81)	193,593	+ 1,717	+19,190
New York City (12/16/81)	55,086	– 40	+ 3,222

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/16/81)	469,596	+ 4,907	+40,697
New York City (12/16/81)	111,533	+ 1,053	+ 9,972

Financial Markets

	Wednesday 12/30/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	11.70%	– .03	– 3.34
180-Day Bills†	13.12	– .04	– 1.85
Longest Bills†	13.55	– .17	– .29
Recent Issues:			
13s 12/31/83 (When Issued)	13.94	+ .54	
14 1/8s 12/31/85 (When Issued)	13.74	+ .09	
14 1/4s 11/15/91	14.04	+ .49	
14s 11/15/11	13.48	+ .18	
Municipals:			
Bond Buyer–20 Bond index	13.30%	+ .13	+ 3.54
Blue List Total ($ Million)	$1,222	– $ 39	+ $ 660
30-Day Visible Supply ($ Million)	$1,787	– $ 95	+ $ 922
Total	$3,009	– $134	+ $1,582
Corporates:			
Moody's Aa Composite (12/29/81)	15.35%	+ .09	+ 1.79
30-Day Visible Supply ($ Million)	$8,937	+ $325	+ $5,400
Stocks:			
Dow-Jones Averages:			
Industrials	873.10	+ 3.43	– 90.89
Transportation	378.44	– 2.14	– 19.66
Utilities	109.34	– .25	– 5.08
65 Stocks	347.02	– .02	– 26.42
Standard and Poor's 500 Stocks	122.30	– .01	– 13.46
N.Y.S.E. Composite Index	70.90	– .06	– 6.96
N.Y.S.E. Avg. Daily Vol. for Week (000's)	32,693	–15,591	– 595

* 46% Taxable equivalent 24.63%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Wednesday 12/30/81	Week Ago
Overnight	13.00%	12.63%
1 month	13.38	13.69
3 month	13.88	14.13
6 month	14.88	15.19
1 year	14.88	14.75
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	14.65%	14.60%
Long Term (7 to 15 yrs.)	15.10	15.10

FOREIGN EXCHANGE SPOT RATES

New York Opening (12/30/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02603	38.41
Canada	.8446	1.1840
Denmark	.1355	7.3775
France	.1744	5.7325
Germany	.4412	2.2665
Italy	.0008278	1208.00
Japan	.004552	219.70
Mexico	.03807	26.27
Netherlands	.4013	2.4920
Switzerland	.5539	1.8055
U.K.	1.9010	.5260

the weakening pace of economic activity, the largest declines may be yet to come, as corporations trim further production, inventories and employment. What is more, as businesses step up their refunding of short-term debt in the long-term bond markets, further downward pressures on short-term rates will appear.

In addition, seasonal factors should help prompt weaker credit demands and interest rates over the next few weeks, since short-term business loan demand usually fades in the early part of a new year. During the past ten years, commercial and industrial loans outstanding have declined slightly on average between December and the middle of February, indicating that a combination of seasonal and cyclical factors could offset the impact of any hesitancy on the part of the Fed to loosen the credit reins further. H

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